

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 16867

DEPARTMENT PASS TREASURY FOR DON SYVRUD FROM AMMERMAN

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: ECONOMIC ASSESSMENT AND SHORT-TERM FORECAST OF
THE U.K. THROUGH 1976; UPDATE

REF: LONDON 15193

1. FORECASTS IN REFTEL ON OUTLOOK FOR UK ECONOMY REMAIN
UNCHANGED, EXAAPT FOR REVISED ESTIMATES MADE BY H.M.
TREASURY ECONOMISTS ON DOMESTIC ECONOMY AND INCREASED SIZE
OF DEFICIT ON BALANCE OF TRADE AND CURRENT ACCOUNT.

2. ECONOMISTS IN H.M. TREASURY REPORT THAT INTERNAL FORE-
CASTS HAVE NOU BEEN REVISED. DATA IN PARA 20 OF REFTEL
ARE CHANGED AS FOLLOWS (YEAR ON YEAR), WHICH REPRESENT IN-
FORMAL VIEWS MF ECONOMISTS CONCERNED. IT IS NOT, REPEAT
NOT, AN OFFICIAL INTERNAL FORECAST, BUT RATHER WHAT KNOW-
LEDGEABLE H.M. TREASURY CAREER STAFF THINK IS LIKELY TO
HAPPEN. PERCENTAGE CHANGE UNLESS OTHERWISE NOTED.

	1975	1976
REAL GDP	-1.8	2.8
MANUFACTURING PRODUCTION	-9	3
MANUFACTURING INVESTMENT	-13.5	-10
RETAIL PRICES	24.5	13

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UNEMPLOYMENT (MONTHLY AVG.) 924 1.1 TO 1.4 MILLION

TRADE BALANCE (BILLIONS/POUNDS)	-3.2	-3.0
INVISIBLES (BILLIONS/POUNDS)	1.4	1.2
CURRENT ACCOUNT (BILLIONS/POUNDS)	-1.8	-1.8

3. SOURCE MADE DATA AVAILABLE ON UNDERSTANDING IT WOULD BE KEPT CONFIDENTIAL WITHIN U.S. GOVERNMENT AND NOT REPEAT NOT REPEATED BACK TO U.K. MINISTERS, OFFICIALS OR OTHER GOVERNMENTS. IT IS ESSENTIAL TO RESPECT THIS ADMONITION.

4. THE ABOVE FORECAST IS MORE REALISTIC AND PLAUSIBLE THAN THE EARLIER ONE IN REFTEL FROM H.M. TREASURY SOURCES, MUCH CLOSER TO OUR OWN ESTIMATES OF LIKELY OUTTURN (PARA 24 REFTEL). NOTE THAT H.M. TREASURY'S PRODUCTION ESTIMATE IS MANUFACTURING, NOT TOTAL INDUSTRIAL, AS IN OUR OWN ESTIMATES. MANUFACTURING INDEX ACCOUNTS FOR 75 PERCENT OF THE ALL-INDUSTRIES PRODUCTION INDEX, HAD BEEN ROUGHLY ONE TO TWO POINTS HIGHER THAN TOTAL INDUSTRIAL PRODUCTION INDEX EARLIER IN YEAR, HAS FALLEN FASTER DURING 1975 THAN ALL INDUSTRIES INDEX. IN EFFECT, H.M. TREASURY ECONOMISTS HAVE REVISED THEIR ESTIMATES TO SHOW A SHARPER FALL IN 1975 AND A SHARPER RECOVERY IN 1976. THEY SEE MANUFACTURING PRODUCTION MORE VOLATILE THAN GDP. UNEMPLOYMENT FIGURES ARE A MONTHLY AVERAGE FOR U.K., WHICH AGAIN GENERALLY COINCIDE WITH OUR OWN ESTIMATES. THE 13 PERCENT RETAIL PRICE INCREASE FOR 1976 WAS GIVEN WITH CAVEAT THAT IT REPRESENTS THE GOVERNMENT'S POLICY OBJECTIVE: THE WORKING ASSUMPTION IS THAT IT WILL SUCCEED. OVERALL, H.M. TREASURY ECONOMISTS SEE FAIRLY WEAK RECOVERY EARLY NEXT YEAR, WITH MORE NOTICEABLE IMPROVEMENT IN SECOND HALF OF 1976.

5. DUE TO REVISIONS IN THE 1975 TRADE AND CURRENT ACCOUNT DATA (SEE LONDON 16514), THE FOLLOWING FIVE PARAGRAPHS SHOULD BE INSERTED AS REPLACEMENTS FOR PARAS 14 THROUGH 18 OF REFTEL TO REFLECT THE REVISED AND UPDATED STATISTICS. THE CURRENT ACCOUNT FORECAST IN ITEM F OF PARA 24 SHOULD BE CHANGED TO -1.8 TO -2.0 FOR BOTH 1975 AND 1976.

6. THE CONTINUING EFFECTS OF STERLING DEVALUATION AND THE FORCES OF DEEPENING DOMESTIC RECESSION ARE HAVING A BENEFICIAL AND MEASURABLE IMPACT ON THE UK BALANCE OF PAYMENTS
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POSITION. WHILE THE OVERALL CURRENT ACCOUNT PERFORMANCE DURING THE SECOND HALF OF 1975 WILL NOT SHOW IMPROVEMENT TO THE DEGREE EXPERIENCED IN THE FIRST HALF, THE CURRENT ACCOUNT DEFICIT FOR THE YEAR AS A WHOLE WILL BE ABOUT 45 TO 50 PERCENT LESS THAN THAT RECORDED IN 1974. DURING THE FIRST NINE MONTHS OF THE YEAR, THE CURRENT ACCOUNT WAS IN DEFICIT BY 1,434 MILLION POUNDS COMPARED TO 2,597 MILLION POUNDS DURING THE SAME PERIOD IN 1974.

7. THE AREA MF MOST NOTICEABLE IMPROVEMENT IS IN TRADE IN
GOODS OTHER THAN PETROLEUM PRODUCTS. DURING THE FIRST
NINE MONTHS OD 1975, THERE WAS A DEFICIT OF 6 MILLION

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C O N F I D E N T I A L SECTION 02 OF 03 LONDON 16867

POUNDS IN TRADE OTHER THAN PETROLEUM PRODUCTS COMPARED
TO A 1284 MILLION POUND DEFICIT RECORDED IN THE FIRST NINE
MONTHS OF 1974. IN THE FIRST HALF OF THE YEAR, EXPORT
VOLUME GREW RELATIVE TO IMPORTS, WHILE THE VALUE OF EX-
PORTS GREW AT A MUCH MORE RAPID RATE' THEREBY PRODUCING A
FAVORABLE TERMS-OF-TRADE EFFECT. FUNDAMENTALLY, IMPORTS
WERE DOWN DUE TO THE REDUCED LEVEL OF CONSUMER EXPENDITURE
AND THE RAPID RATE OF INVENTORY DESTOCKING. IT IS NOT
ANTICIPATED THAT INVENTORIES WILL BE REBUILT UNTIL SUCH
TIME AS THERE ARE POSITIVE SIGNS OF AN UPTURN IN DOMESTIC
CONSUMPTION. THIS LOW LEVEL OF CONSUMER DEMAND COUPLED
WITH AN EXPECTED UPTURN IN WORLD TRADE SHOULD CONTINUE TO
AID THE CURRELT ACCOUNT POSITION THROUGHOUT THE REMAINDER
OF THE YEAR AS WELL AS IN THE FIRST HALF OF 1976. H. M.
TREASURY STAFF EXPECTATIONS ARE THAT WORLD TRADE WILL SHOW
AN ANNUAL RATE OF INCREASE OF 15 PERCENT PER QUARTER DUR-
ING 1976, WITH UK EXPORT VOLUME INCREASING BY ABOUT NINE
PERCENT PER QUARTER (AGAIN, QUARTERLY INCREASES AT ANNUAL

RATES). THIS MAY BE OPTIMISTIC.

8. THE IMPORTATION OF PETROLEUM PRODUCTS HAS ALSO BEEN AT A REDUCED RATE DURING 1975 COMPARED TO 1974, ALTHOUGH THE IMPROVEMENT IN THIS SEGMENT OF THE VISIBLE TRADE ACCOUNT HAS BEEN LESS SIGNIFICANT THAN IN THE NON-PETROLEUM
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SEGMENT. THE NET BALANCE ON TRADE IN PETROLEUM PRODUCTS SHOWED A DEFICIT OF 2,178 MILLION POUNDS IN THE FIRST 9 MONTHS OF 1975 COMPARED TO 2,504 MILLION POUNDS DURING THE COMPARABLE PERIOD IN 1974. THERE WAS, HOWEVER, CONSIDERABLE DESTOCKING OF PETROLEUM RESERVES DURING THE FIRST HALF OF THE YEAR, AND INDICATIONS ARE THAT THESE STOCKS HAVE BEEN REBUILT DURING THE THIRD QUARTER IN ANTICIPATION OF THE HIGHER OPEC PRICE AND APPROACHING WINTER MONTHS. INDUSTRIAL DEMAND REMAINS LOW AND A MAJOR RESURGENCE SEEMS UNLIKELY OVER THE NEXT 12 MONTHS. AS NOTED, THERE WAS A SURGE IN PETROLEUM IMPORTS IN JULY THROUGH SEPTEMBER. HOWEVER, THE IMPORT VOLUME IS EXPECTED TO RETURN TO THE EARLY 1975 LEVELS BY THE END OF THE YEAR.

9. THERE WERE SEVERAL "SPECIAL" FACTORS DURING THIRD QUARTER WHICH ADVERSELY AFFECTED THE CURRENT ACCOUNT POSITION. THERE WERE IMPORTS OF THREE NORTH SEA OIL RIGS WHICH ADDED NEARLY 200 MILLION POUNDS TO THE IMPORT BILL IN JULY AND AUGUST AND ANOTHER 50 TO 80 MILLION POUNDS IN SEPTEMBER. AQ NOTED, PETROLEUM RESERVES WERE DRAWN DOWN DURING THE EARLY MONTHS OF THE YEAR AND THERE IS EVIDENCE THAT THERE WAS A "RUSH" TO REPLENISH THESE STOCKS BEFORE THE OPEC PRICE INCREASE. TOO, THERE WILL BEGIN TO BE A REDUCTION IN IMPORTS RELATED TO NORTH SEA OIL DEVELOPMENT WHICH ARE CURRENTLY ADDING 500 - 600 MILLION POUNDS PER YEAR TO THE DEFICIT.

10. FOR THE YEAR 1975 AS A WHOLE, WE ANTICIPATE THAT THE CURRENT ACCOUNT WILL BE IN DEFICIT BY 1,800 TO 2,000 MILLION POUNDS COMPOSED OF A VISIBLE TRADE DEFICIT OF 3,200 TO 3,400 MILLION POUNDS AND A SURPLUS ON INVISIBLE TRANSACTIONS OF ABOUT 1,400 MILLION POUNDS. FOR 1976, WE DO NOT ENVISAGE A SUBSTANTIAL IMPROVEMENT OVER 1975 ALTHOUGH SOME BUT NOT ALL U.K. OFFICIALS BELIEVE THAT WORLD CYCLICAL FACTORS WILL FAVOR THE U.K. AND LEAD TO AS MUCH AS 50 PERCENT IMPROVEMENT YEAR ON YEAR. HOWEVER, THE INCREASE IN PETROLEUM PRICES WILL ADD AN ADDITIONAL 300 MILLION POUNDS TO THE IMPORT BILL AND THE CONTINUED DEVALUATION OF STERLING WILL INCREASE THE COST OF NEEDED RAW MATERIALS

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ONCE THE ECONOMY TAKES AN UPTURN. SINCE EFFECTS OF STERLING DEVALUATION ARE MORE RAPIDLY REFLECTED IN IMPORT PRICES THAN IN AN INCREASED DEMAND FOR EXPORTS, WE SEE ONLY LIMITED SCOPE FOR IMPROVEMENT OVER THE NEXT TWELVE MONTHS. BEYOND THAT POINT, THERE IS REASON TO HOPE FOR IMPROVEMENT BASED ON (A) INCREASED EXPORT GROWTH IN RELATION TO IMPORTS AS WORLD TRADE PICKS UP WITH THE UK'S OWN DOMESTIC RECOVERY LAGGING IN THE CYCLE, AND (B) THE GRADUAL COMING ON STREAM OF NORTH SEA OIL, WITH LESSENER IMPORTS FOR ITS DEVELOPMENT AND AN INCREASE IN THE FLOW OF OIL ITSELF REDUCING THE NEED FOR PETROLEUM IMPORTS; THIS TREND IS CONSISTENT WITH INTERNAL HMG AND PRIVATE SECTOR FORECASTS AND WE ARE IN AGREEMENT WITH THEM (SEE LONDON A-528).

11. FINAL SENTENCE IN PARA 27 OF YOUR TYPED VERSION OF OUR CABLE IS GARBLED, KEY WORDS LEFT OUT. SUGGEST YOU REVISE IT AS FOLLOWS: QUOTE IN CONTRAST, THE CHANCELLOR'S BASIC AIMS ARE CORRECT BUT UNTIL THE UK CAN FIND A MEANS

OF INCREASING INVESTMENT AND PRODUCTIVITY IN MANUFACTURING
INDUSTRY, THE UK WILL NOT PERFORM AT ITS FULL POTENTIAL.
UNQUOTE.

12. A FINAL COMMENT: UK'S GENERAL SHORT-TERM TACTICS
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REMAIN UNCHANGED; NO SIGNIFICANT GOVERNMENT MEASURES TO
REFLATE WITH EXPANSION IN EXPORTS STILL HOPED FOR AS A
MAJOR PRIME MMVER BEHIND GROWTH NEXT YEAR. DURING OFF-
RECORD DINNER CONVERSATION LAST WEEK, CHANCELLOR HEALEY
SAID HE DOES NOT PLAN ANY GENERAL REFLATIONARY MOVES UNTIL
INFLATION IS ALEARLY UNDER CONTROL AND WORLD TRADE HAS BE-
GUN TO PICK UP. IN CONTEXT OF HIS REMARKS, HE IS CLEARLY
HOLDING TO LONGER-TERM STRATEGY OF EXPORT AND INVESTMENT-
LED GROWTH.

RICHARDSON

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